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MART®

BUSINESS IDEAS FOR TODAY'S RETAILERS AND DISTRIBUTORS

JUNE 1986

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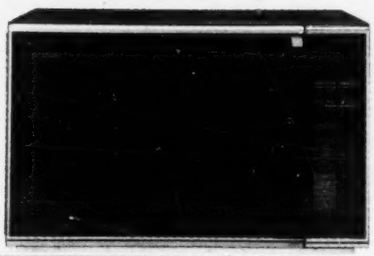

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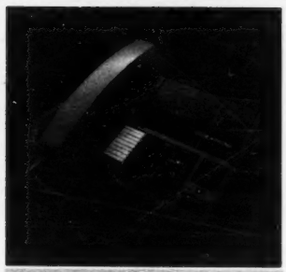
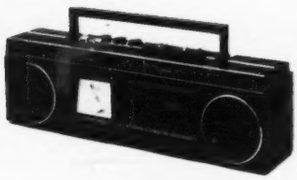
Microwaves may be getting smaller, but they've never been more feature-packed.



TELEPHONES

Smart answering machines lead the way in a category poised for big growth.



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Summer CES brings new features, configurations and profit opportunities.

VIDEO SOFTWARE

The door to mass market video is finally opening at retail.

MART

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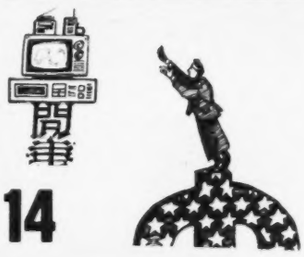

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Americans hooked on video

In-depth VCR market study reveals that intent to buy is strong among owners and non-owners.

The video cassette recorder has become such an integral part of America's home entertainment psyche that 95 percent of all VCR owners say they would replace their machines — much like they would a TV set — should it fail beyond repair.

In fact, it appears that we're gradually becoming hooked on home video. During a typical week, VCR owners — who now represent more than a third of all TV households — spend an average of 9.3 hours playing video cassettes and 6.1 hours recording their favorite shows. It looks as though the "TV generation" may indeed be replaced by the "VCR generation."

These are just a couple of the many interesting findings of an in-depth VCR market study released by the Electronic Industries Association. The report confirms something that most of us have suspected for a while now: The VCR is here to stay and is destined to follow in the ubiquitous footsteps of television. But beyond that, it also sheds light on which factors most influence a purchase decision, the VCR's performance record, and how second-time and replacement purchases fit into the scheme of things.

Prepared under the direction of the EIA's Consumer Electronics Group by Market Facts Inc., the survey was conducted during the first two months of this year. A nationally representative sample of 10,000 households received questionnaires, and 75 percent — or 7,525 U.S. households — responded.

The VCR market has reached the point where a substantial market for second VCRs and replacements is now developing. Forty-one percent of current VCR owners indicated the intention to buy a tabletop VCR over the next year. Current owners also are very intersted in adding other video products to their electronics collection. More than half said they were likely to buy a video camera or camcorder, indicating that this product category's upward trend should continue.

Furthermore, of the VCR owners expecting to purchase another VCR during the next year, 56 percent said it will be an additional unit for another room or individual in the household. 27 percent indicated that it will be to upgrade the main VCR, and 17 percent said the new unit would replace a VCR that will no longer be used.

As for those consumers who have not yet jumped on the video bandwagon, more than two-thirds said they intend to buy a VCR. Only 10 percent, however, expressed the likelihood of buying a camera or camcorder, confirming what many manufacturers have been saying all along: Until they get their feet wet with a VCR, consumers are not as likely to be interested in a camera. Renting a VCR is a primary factor leading to the purchase of a video product. Seventy percent of non-VCR owners who have rented said they were "very likely" or "somewhat likely" to purchase a VCR in the next 12 months.

The format of choice, as expected, is overwhelmingly VHS. 8mm is on the minds of 2 percent of consumers who intend to buy a video recorder, while Beta is the format of choice for 15 percent of the non-owners. The 15 percent figure may be overstated, however, due to consumer confusion, the EIA notes.

Of current VCR owners who plan to make additional video hardware purchases, 10 percent chose Beta and 4 percent chose 8mm, indicating perhaps that the awareness level of the new 8mm format is higher among VCR owners than the general public.

The study concluded that at the end of 1985, about 35 percent of all American households owned video recorders. This number is inflated by a couple of percentage points, the EIA believes, because of enthusiastic respondents who intend to purchase a VCR but filled out the questionnaire as if they had already bought one.

While 15 percent of all VCR owners reported having two or more machines, the mainstay purchaser is still the first-time buyer who accounted for 83 percent of all sales last year. Remaining purchases were split almost evenly between replacements, upgrades and additional machines. But, as indicated earlier, replacement and upgrade purchases appear to be on the rise.

The base of American VCR owners is certain to broaden as prices fall, but today's typical video household is still larger, younger and has a higher than average income. Fifty-six percent of VCR owners are part of a household with three or more people; 61 percent have an annual income of $25,000 or more; and 53 percent are headed by persons under 40-years-old. Take note, because this household will continue to be the best market for sales in coming months.

Not surprisingly, 90 percent of the VCRs acquired in 1985 were VHS format. VHS's market share has risen from 71 percent in 1980, while Beta's share has dropped from 25 percent in 1980 to 9 percent in '85. By the end of last year, the fledgling 8mm format had captured a one percent slice of the pie.

The average price paid for a VCR has dropped 40 percent; from $728 in 1981 to $420 in 1985. And for those machines purchased last year, picture quality, format and price were cited as the three key purchase factors. Buyers of VCRs costing more than $500 placed more importance on a number of other factors, including manufacturer's reputation and special features, than those who purchased less expensive units.

Over time, only two factors revealed a clear trend — price and stereo capability. Both of these considerations became important to an increasing number of buyers between 1981 and 1985. Last year, for example, price was cited by 72 percent of all VCR owners as very important, while stereo was termed very important by 28 percent.

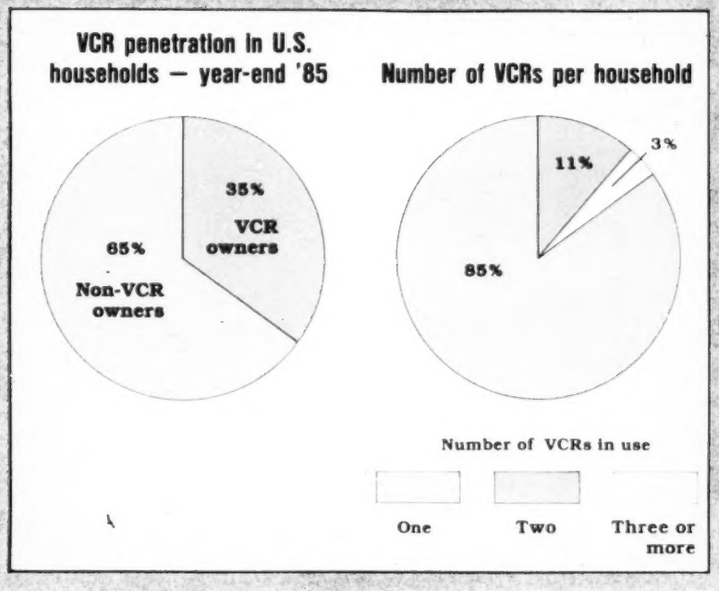
Features most common to VCR's purchased in 1985 were high speed forward or reverse (92 percent), cable compatibility (84 percent), wireless remote control (71 percent) and one-touch recording (66 percent). More than one-third of the decks purchased last year were either stereo or hi-fi models.

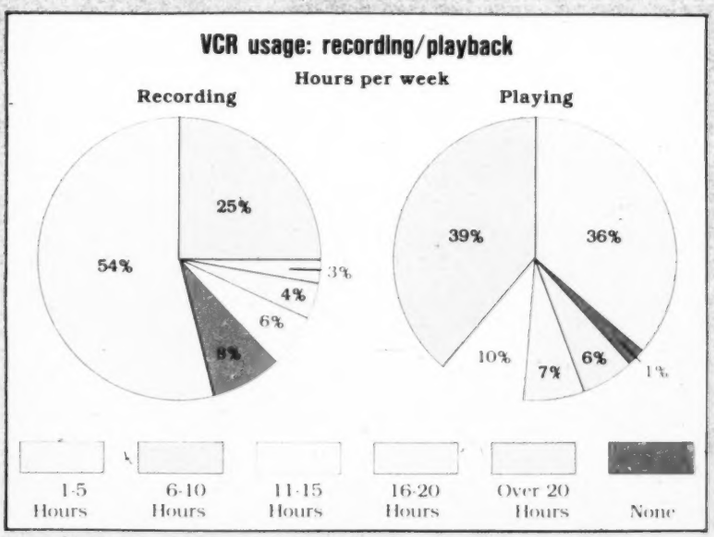
So far, the VCR has proven to be a reliable product. Although 43 percent of the VCRs purchased in 1981 have been serviced or repaired at least once — and 39 percent of these were done at no charge to the consumer — 93 percent of those machines are still working.

Retailers with a service department will be happy to know that a steadily increasing number of consumers are looking to them as *the* place to bring merchandise that needs fixing, instead of the traditional TV/electronic repair shop. Use of the latter outlet has witnessed a steady decline in the last five years.

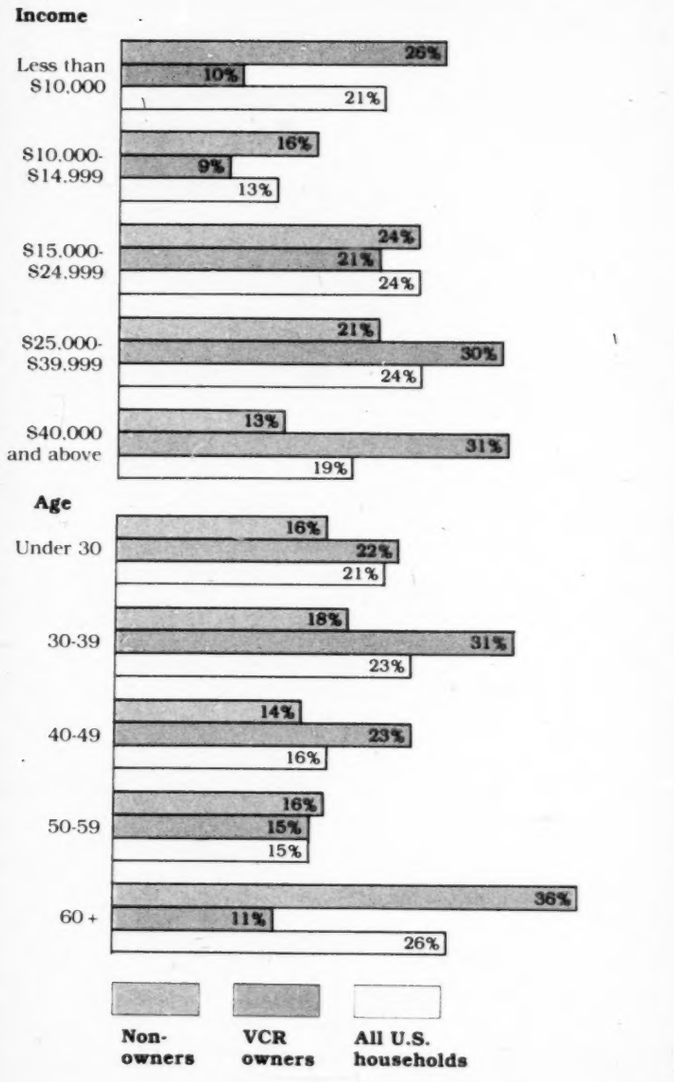
One final point to keep in mind — especially around the holidays: More people are looking to the VCR as that perfect gift. Last year, 21 percent of the VCRs sold were gifts. Now, if we could only tie the rising interest in stereo sound in with that . . . □

Bob Ankosko

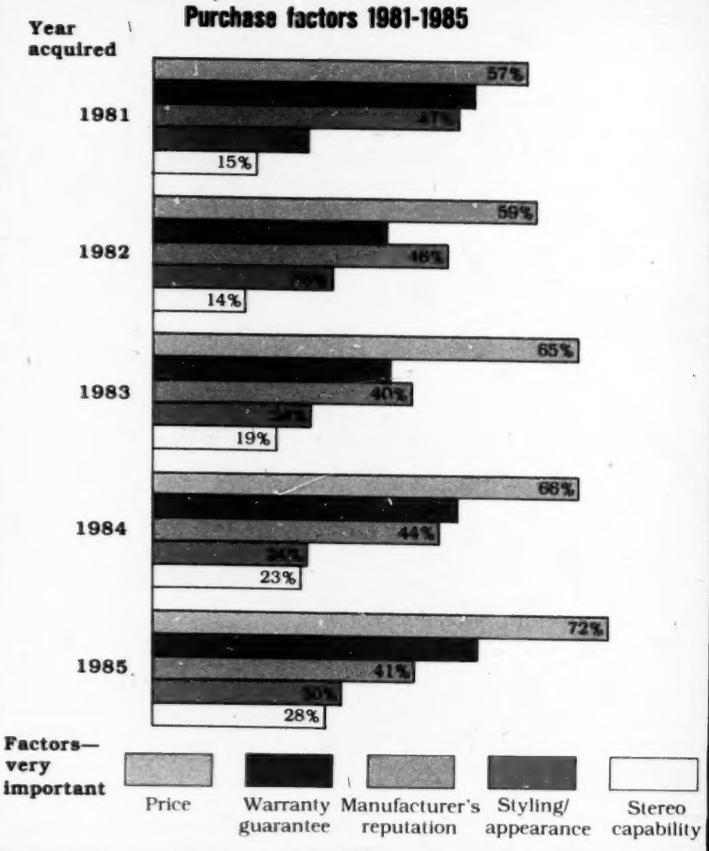




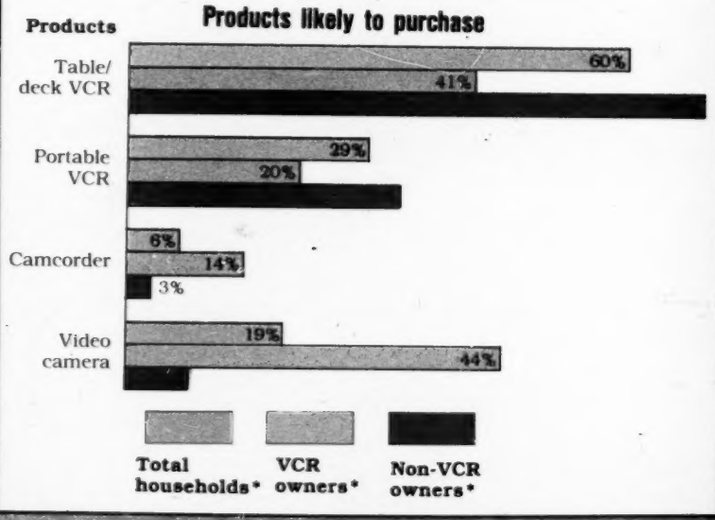
VCR owners/non-owners: income and age



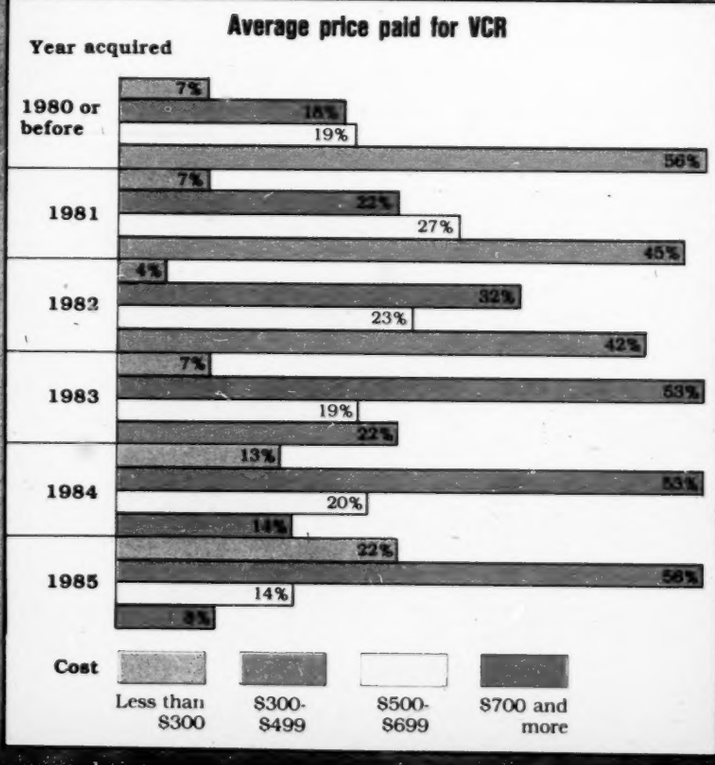
Purchase factors 1981-1985



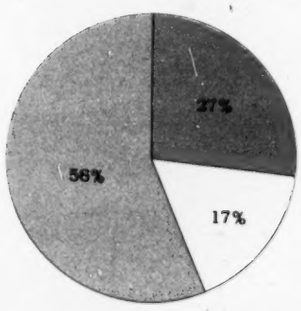
Products likely to purchase



Average price paid for VCR



Reasons for planned purchase — VCR households



Reasons %

- Replacement VCR
- Upgrade current main VCR
- Pure additional VCR

The dollars and sense of selling video

With retail sales revenue from prerecorded video cassettes expected to reach $2.1 billion this year, there's reason to stop and take notice.

When most people think about retailing prerecorded videocassettes they think of folks dropping by the corner video shop and plunking down $2 for an overnight rental of *Beverly Hills Cop*. And by and large, that's what the video business has been all about. *So far.*

But American consumers spent almost $1.2 billion last year to *buy* videos for their permanent home libraries. This year, retail sales revenues from prerecorded cassettes are expected to nearly double to $2.1 billion. (See chart.)

At a minimum margin of, say, 30 percent, that works out to $630 million in retail profits this year, based on a projected 60 million sales transactions. "Consumers *will* buy if you make the product available to them," says Lieberman Enterprises senior VP Jim Hanke.

The principal reason for this upsurge in video sales is the declining retail price of many types of programs. Children's programming selling for $10-$12 abounds. How-to tapes, classic movies, video travel guides, exercise programs and music videos can all be had for under $20.

This phenomenon is bringing sweeping changes to the business of retailing prerecorded video. Though the overnight rental is still the overwhelmingly dominant mode of transaction, sales are expected to account for 38 percent of the total retail revenues generated by video this year. *Cassette sales will account for half of all retail revenue in 1988 and will exceed rental revenue by the end of the decade*, according to industry research.

A significant amount of the $2.1 billion spent to buy prerecorded cassettes this year, moreover, will be spent in outlets other than video specialty shops. Convenience stores, supermarkets, drug stores, discounters, book and record stores and other mass merchants and large volume retailers will all have their shot at a piece of the action.

Today it is feasible to get into the business of *selling* prerecorded videocassettes without also having to establish a costly, labor-intensive rental operation.

Lieberman, a major rack jobber, turned $9 million in sales of prerecorded videocassettes through 767 racked departments in 1985, according to Hanke. "We expect to do about $15-$16 million in sales in 1986," he adds.

During the Christmas season last year Lieberman did a big push in its racked departments on cassettes retailing for $19.95 to $24.95. The effort resulted in the sale of 152,000 units worth about $3 million.

Admittedly, a number of artifacts of the entrenched rental orientation of the video software business will have to be modified if mass marketing video is to be a long term success. The most important of these — margins, dating and returns.

Compared to other mass market items such as books or toys, retail margins on prerecorded video are somewhat slim — traditionally about 30 percent if sold at list price. As prices have declined, though, retail margins have been further squeezed.

But the entry of book publishers, toymakers and other packaged goods manufacturers into the business has begun to alter tradition. In marketing video software through their regular toy accounts, for example, Parker Bros., Mattel, Remco, and others have generally set prices and margins to conform to normal levels within that distribution channel.

The conventional video program suppliers, including the major studios and independents, have been wooing mass merchants and other large volume retailers with improved terms, as well. CBS/Fox, Vestron, RCA/Columbia, Prism have frequently voiced their understanding of the need to accommodate volume buyers.

This is being accomplished in part by selling directly to retail accounts, rather than through independent wholesalers, as is typical of the video specialty market. Selling direct allows the supplier to add eight to ten points to the retailer's margin that would ordinarily go to a wholesaler.

"We understand the nature of other retail businesses is different from the video specialty market and we need to adjust," acknowledges Court Shannon, executive VP of Karl-Lorimar Home Video. Karl-Lorimar has been among the most aggressive video program suppliers in pursuing mass market distribution. "But," Shannon warns, echoing the major studios, "we do not plan to give away the store to gain distribution."

The issue of returns has been the most contentious one confronting video software suppliers in their quest for mass market/large volume retailer distribution. Unlike other industries, such as records and books, video retailers have never enjoyed outright returns privileges, but have had to make do with more limited stock balancing programs.

Under a typical stock balancing program, wholesalers and retailers are allowed to exchange 10 to 15 percent of their inventory quarterly for a comparable amount of new inventory. Cassettes are exchanged on a one-for-one basis.

Cracks have already begun to form in the program suppliers' united front, however. In the fourth quarter of 1985, several suppliers, including major studios such as Paramount, were offering some mass merchants 100 percent returns.

Don Edwards, who is in charge of Waldenbooks' audio and video departments, cautions program suppliers, "Don't expect a buyer to take less than a 50 percent returns allowance — and more likely 100 percent — and 120 day dating on at least 60 percent of his total purchase — and probably 100 percent."

Lieberman chairman David Lieberman believes terms will probably settle around 25 to 30 percent — roughly comparable to the record industry. For untested product, as again is true in the record industry, 100 percent may be offered in the hope of obtaining shelf space. □

Paul Sweeting

'We understand the nature of other retail businesses is different from the video specialty market and we need to adjust.'

Court Shannon
Karl-Lorimar

Dating policies between program suppliers and video specialty dealers have also been more restrictive than large volume retailers are accustomed to. Video software wholesalers generally have terms of net 30 days with the suppliers, secured by letter of credit. Meanwhile, nearly half of video specialty dealers are on a C.O.D. basis with their wholesalers. Of those that do have credit, terms are again generally net 30 days.

Competition from program suppliers coming to the video market from other industries is helping change that situation as well. Already, several suppliers have begun offering 120 day dating on mass market product.

Sales of Prerecorded Videocassettes to Consumers

Year	Total retail revenue from prerecorded video	Retail revenue from sales	Percent of total
1986	$5.9 billion	$2.1 billion	35.5%
1987	$7.2 billion	$2.9 billion	40.3%
1988	$7.7 billion	$3.6 billion	46.7%
1989	$7.6 billion	$3.9 billion	51.3%
1990	$7.6 billion	$4.0 billion	52.6%

Source: Video Marketing

The total retail market for prerecorded video in 1986 will total $5.9 billion. Of that, $2.1 billion will be accounted for by sales (rather than rentals) to consumers. By the end of the decade the market will total $7.6 billion, including $4.0 billion from sales of cassettes.